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Ann E. Misback, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

**Re: Community Reinvestment Act Advance Notice of Proposed Rulemaking**
**Docket No. R-1723 and RIN 7100-AF94**
**Notice: Reforming the Community Reinvestment Act Regulatory Framework**

To Whom It May Concern:

United Fidelity Bank, FSB (we or UFB) appreciates the opportunity to comment on the Federal Reserve's (you or the Federal Reserve) Advanced Notice of Proposed Rulemaking (ANPR) regarding the Community Reinvestment Act (CRA or Act). The CRA has promoted access to capital and encouraged banks to invest in people and the neighborhoods where they do business, helping to create thriving and healthy communities that are essential to the success of our economy. Since 1996, banks have issued almost $2 trillion in small business loans and community development loans and investments in support of low- to moderate-income (LMI) individuals and geographies. Over the years, the CRA has been updated numerous times to address changes in banking law, to accommodate the state of then-current finance and banking environments, and to promote social justice in banking practices.

We agree that it is again an appropriate time to update and modernize the CRA to synchronize the Act with the manner in which banks now deliver modern banking services resulting from changes in technology over the years, and to account for and fairly accommodate modern finance structures and techniques that are most effectively used to finance community development in the multi-family affordable housing arena. We believe that the proposals in the ANPR contain significant missteps and hope that the Federal Reserve will take this opportunity to address certain of these deficiencies before it finalizes changes to the CRA.

## I. RELEVANT BANK BACKGROUND

UFB is a $1.4 billion federal savings bank with eighteen branches in Indiana, Illinois, Colorado, Florida and the U.S. Virgin Islands. Over the last twenty-five years, UFB has made loans

and investments in excess of $710 million in community development activities comprised predominantly of financing affordable housing and economic development in redevelopment districts. Currently, approximately 70% of our assets are comprised of such loans and investments. UFB considers the CRA to be good business resulting in well performing assets that contribute to our financial success while also contributing to the economic health of our communities and the people who live and work within them. Our primary focus during this period has been on investing in community development, primarily focusing on affordable housing that benefit LMI individual and communities. I would venture to say on a ratio of loans and investments to bank assets, UFB holds one of the highest (if not the highest) concentrations of assets from this class among national banks and federal savings associations. We estimate that 1 out of every 500 families in the United State have lived in affordable housing that UFB or its affiliates have financed, developed, constructed and/or managed over the past 35 years.

With this being said, the legal framework and structure that you propose to deploy under the ANPR discourages banks from using the types of financing structures that allow banks to most efficiently deploy capital in the affordable housing arena so that banks may maximize the good that banks may do for LMI individuals and communities. For example, as we will discuss in the next section, there is no reason for the CRA to treat certain types of **investments** (that we will describe in the next Section) differently than it treats **loans** in many instances. For large banks, the ANPR suggest a framework that will require 4 distinct tests for banks, including the "retail lending subtest" (that examines the ratio of loans to deposits) and separate and distinct "community development financing subtest" (that examines certain investments). As proposed, there are items that banks will receive credit for only under the community lending tests, that banks should have the option of receiving credit for under the lending tests and loan ratios.

Banks should be given the option to designate certain investments (as defined under the current version of the CRA and proposed in the ANPR) as "loans" for purposes of the retail lending test[1]. Treating these items differently in this context is arbitrary, and not providing banks with the option creates bad results for the LMI individuals and communities, and for banks.

The retail lending test, similar to other lending test in the current version of the CRA, will become a limiting factor in our ability to invest in LMI communities because it forces banks to manage to a **ratio of loans to deposits** and completely ignores and excludes investments, such as Federally Guaranteed Qualified Investments (as defined below), that provides greater benefits to the LMI communities and are safer and sounder funding than conventional loans. This requirement or oversight is an arbitrary limit that on the margins has the practical effect of impeding the safe and sound deployment of capital to meritorious affordable housing projects. The CRA should be updated to encourage use of this modern financing structure to finance affordable housing instead of discouraging such use. For a detailed example please see the next section.

[1] The other options described below would also address the problem described here.

UFB request that the Federal Reserve either (i) allow banks the **option** to designate and include (a) Government National Mortgage Association (GNMA) issued agency certificates[2] that are "qualified investments" ("**GNMA Qualified Investments**"), and (b) other "qualified investments" that are guaranteed by the full faith and credit of the U.S. federal government as to the timely payment of principal and interest ((a) and (b) being collectively referred to as "**Federally Guaranteed Qualified Investments**") as **"loans"** for purposes of its "lending tests" and "loan to deposit ratios" instead of requiring banks to designate them as **"investments"** under the CRA and excluding them from such tests and ratios, or (ii) modify the CRA statutes and regulations to allow for combined "loan and investment" tests in assessment areas or on a bank-wide basis, or (iii) modify the CRA in a manner similar to the changes recently made by the OCC in 2020 basing the lending tests on "loan to loan tests"[3], not on "loan to deposit tests".

## II. FEDERALLY GUARANTEED QUALIFIED INVESTMENTS

The differences between most Federal Guaranteed Qualified Investments and conventional loans made by banks is at-best form over substance from a structural perspective. Allowing banks to treat these structures as "loans" will yield quantifiable benefits to financing affordable housing, but has no quantifiable risks or disadvantages to banks, LMI individuals or communities, or any other stakeholders that we can discern. Changing this requirement is low-hanging-fruit that will yield substantial benefits to affordable housing and LMI communities.

From a borrowers' perspective, there is absolutely no difference between the GNMA Qualified Investment structure and that of "conventional" loans they otherwise use to finance the debt component of multi-family affordable apartment projects. Under the GNMA Qualified Investment structure, loans are made available in amounts underwritten by banks to provide the necessary debt financing to borrowers/developers to construct affordable housing projects, which is the ultimate goal of CRA – to make this funding available for the benefit of low- to moderate-income individuals and communities. From the banks' perspective, they are simply making loans with an additional feature (the GNMA certificate – which is simply similar to a credit default derivative from the Federal government) that credit-enhances the transactions in a manner that mitigates the risks-of-loss to banks from a defaulting borrower; an often untenable risk that is so often associated with making loans to finance affordable housing. Being encouraged (or, at least not being discouraged) by the CRA regulations to employ this GNMA financing structure makes banks more likely on the margin to finance affordable housing projects.

There is little substantive difference in financing affordable housing through GNMA credit-enhanced structures but treating this credit-enhanced structure differently than loans under CRA regulations limits the use by banks of this structure in excess of certain CRA thresholds/ratios. In other words, if banks fund "too many" multi-family affordable housing

[2] Specifically, GNMA CLC and PLC certificates associated with HUD 221(d)(4) new construction and substantial rehab and 223(f) HUD refinancings.

[3] Based upon comparison of (i) the (A) percentage loans to LMI individuals and community to (B) the general pool of loans in the applicable category, to (ii) a percentage comparator derived from peers.

projects or do too much good through this safe and sound structure it causes imbalances in the loan-to-deposit ratios prescribed under CRA (and loan-to-deposit ratios that you propose to continue under the ANPR) because GNMA Qualified Investments are not included as "loans" in the loan-to-deposit ratio under CRA. Making the narrowly tailored change to allow banks the option to include Federally Guaranteed Qualified Investments as loans in the CRA regulation[4] and your proposal under the ANPR will encourage more investment in affordable multi-family housing in a much more safe and sound manner when compared to loans made without this credit-enhancement feature.

## III. ADDITIONAL CONSIDERATIONS OF STRUCTURING TRANSACTIONS WITH FEDERALLY GUARANTEED QUALIFIED INVESTMENTS VERSUS OTHER COMMUNITY INVESTMENTS

In additional to the discussion of structuring loans, the risk-of-loss profile of Federally Guaranteed Qualified Investments, such as the Qualified Investments and other similar financing structures, from a safety and soundness perspective is **multiples better than other "qualified investments" made for similar purposes** ("Other Community Investments"). Many of the Other Community Investments represent equity interests in enterprises, with risks-of-loss profiles that are generally significantly higher than the risk-of-loss profiles for conventional loans. Most Other Community Investments are structured to take equity interests (i.e., returns based upon financial performance of entities and underlying projects). That is not the case with Federally Guaranteed Qualified Investments where the risks-of-loss is based upon **the solvency and creditworthiness of the U.S. federal government**.

As an example, GNMA Qualified Investments are in substance nearly always loans to entities to construct multi-family apartment complexes for low- to moderate income individuals (and in the case of UFB, invariably low- to very low-income individuals). To credit-enhance such transactions, the loans are structured to produce and accommodate certificated federal guarantees of timely principal and interest repayment. Under the current CRA rules and those that you propose under the ANPR, we are forced to treat this slight difference in structuring as a "qualified investment" but not allowed to include them as "loans" for purposes of lending tests and loan-to-deposit ratios under the CRA.

On the other hand, in numerous very similar transactional structures you come to exactly the **opposite result** when you permit banks to treat a nearly identical structure as a "loan" for purposes of CRA lending tests and ratios. Loans that are made by banks to finance the construction of multi-family apartments and credit-enhanced with federal insurance from the Federal Housing Agency (FHA), but that are otherwise virtually identical in every other way (to loans described in the prior paragraph, except that FHA does not guarantee timely payment of

[4] The other changes proposed above of (i) modifying the CRA statutes and regulations to allow for a combined "loan and investment" test in assessment areas, or (ii) modifying the CRA in a manner similar to the changes made by the Federal Reserve where the lending test are based upon "loan to loan tests", not "loan to deposit tests" will also solve this problem.

principal and interest), are treated as "loans" for purposes of CRA lending tests and ratios. The structures (other than the name of the federal agency that delivers the credit-enhancement and the quality of the enhancement) are virtually identical from nearly all other practical perspectives. The result of allowing banks to treat one structure as a "loan" for CRA purposes and denying the other structure such treatment is arbitrary and inequitable to banks that choose to finance through the GNMA structure[5] and are detrimental to LMI individuals and communities.

This inequity is further magnified when you consider the fact that GNMA guarantees "timely" payment, and FHA insurance does not. The GNMA structure is a more safe and sound structure for banks than the FHA enhancements, yet the CRA and the proposals under the ANPR effectively penalize and discourage banks from using this modern innovative, creative and complex financing structure beyond a certain threshold by withholding essential CRA credit based upon such an arbitrary distinction between finance structures. We find it somewhat ironic that in no less than 43 places in the current CRA regulation, banks are encouraged to engage in innovative, creative and complex finance structures to promote the goals of CRA, and when we and other banks engage in such activities, we are effectively penalized by the CRA and will continue to be penalized if you implement the proposals in the ANPR without modification. We request that these differences be rectified by changing the CRA rules as described in herein.

If banks are forced in some cases to continue to avoid use of these GNMA guarantees (and other Federally Guaranteed Qualified Investments) to finance such projects, to mitigate additional credit risks, banks will either increase interest rates and debt service, lower loan sizes, and/or utilize less safe and less sound credit-enhancement techniques, each of which on the margin may make many of these transactions infeasible, un-financeable, or more likely to fail under the additional financial pressures these often inferior financing structures for affordable housing levy upon projects. Depriving projects of the additional safety-net described in the foregoing sentence, (i) increases the probability that projects will fail because more of the net operating income will be used to pay debt-service on the financing, (ii) decreases the probability that such projects will find the additional equity needed due to down-sizing of loans to adjust for the additional risk, and (iii) increases the probability that banks will not fund otherwise meritorious projects due to additional credit risks; all of which are bad results for low- to moderate-income individuals, and community development projects.

## IV. RECOGNITION BY OTHER BANKING STATUES OF THE DIFFERENCES BETWEEN FEDERALLY GUARANTEED QUALIFIED INVESTMENTS AND OTHER COMMUNITY INVESTMENTS

We do not believe that it is appropriate to treat Federally Guaranteed Qualified Investments and Other Community Investments as one-and-the-same under the CRA statutes

[5] In addition to FHA guarantees, loans that are enhanced with investment grade guarantees, LOC from the Federal Home Loan Banks, and numerous other credit-enhancement structures are categorized as loans, and there is no reason to treat the GNMA credit-enhancement differently under the CRA. The CRA and rules proposed in the ANPR treat the GNMA instrument as a less favored enhancement, while, as we explain later, other bodies of banking law provide favorable dispensation for GNMA and similar enhancement structures.

and regulations for purposes of the lending tests and ratios. It is also important to recognize that other banking statutes and regulations have no limitations (such as the test and ratios in CRA) or restrictions that limit banks from participating in the GNMA Qualified Investment transactions. Please also note that other areas of banking law, specifically loan-to-one-borrower, lending and investment powers, and transactions with affiliates, permit banks to invest in virtually unlimited amounts in structures that are credit-enhanced with Federally Guaranteed Qualified Investments, but significantly limit the amount that banks may invest in Other Community Investments structures. As a practical matter many of these statutes and regulations encourage banks to make loans and invest through Federally Guaranteed Qualified Investment structures. The statutes and regulations treat the two classes of investment distinctively differently. We believe that it is time for CRA to acknowledge the differences and make similar advances in its legal framework.

There is no good reason to treat Federally Guaranteed Qualified Investments like Other Community Investments (that often have risks of loss profiles that are generally higher than those associated with conventional loans) under the CRA, but there are very good reasons to allow banks to treat Federally Guaranteed Qualified Investments like loans under the current CRA statutes and regulations for purposes of the lending tests and ratios required by the current CRA and that which you propose in the ANPR. Federally Guaranteed Qualified Investments are becoming one of the preeminent credit-enhancement technique to facilitate debt financing of multi-family affordable housing and continuing to <u>not</u> allow banks to treat them as "loans" will force banks to use less than optimal (less safe and sound) finance techniques and structures to support and fund affordable housing projects, or cause banks to not participate in the financing of meritorious community development projects that they would otherwise fund if such arbitrary barriers did not exist. This additional incentive and flexibility is a net benefit to the low-to moderate-income community, banking, and society in general.

All-in-all, we understand the differences in the risks and structures between Federally Guaranteed Qualified Investments, Other Community Investments, and conventional loans. Of the three, (i) Federally Guaranteed Qualified Investments have virtually no-risk of loss due to the federal guarantees of timely payment of principal and interest, (ii) conventional loans have a relatively interim level of risk-of-loss, and (iii) most Other Community Investments generally have the highest risk-of-loss profile. We do not believe that it is appropriate to treat Federally Guaranteed Qualified Investments and Other Community Investments as one-and-the-same under the CRA statutes and regulations for purposes of the lending tests and ratios.

We believe that the Federal Reserve should changes it regulations to encourage the use of Federally Guaranteed Qualified Investments. We again request that the Federal Reserve allow banks flexibility and the option (i) to include Federally Guaranteed Qualified Investments as "loans" for purposes of the lending tests, or (ii) to modify the CRA statutes and regulations to allow for a combined "loan and investment" test in assessment areas or on a bank-wide basis, or

(iii) modify the CRA in a manner similar to the changes recently made by the OCC in 2020 basing the lending tests on "loan to loan tests".

## V. LETTERS OF CREDIT

We believe that letters of credit should also be treated as "loans" for purposes of lending test and loan to deposit ratios and should receive the same consideration as loans made for the same activity. Letters of credit are bona fide extensions of credit for which banks are required to hold capital. In the context of financing multifamily affordable housing for low- to moderate-income individuals, letters of credit are often an indispensable aspect of credit enhancing transactions. Letters of credit in this context facilitate risk-sharing amongst entities and/or transference of risks to more credit worthy entities. Again, other parts of banking law treat letters of credit as loans or extensions of credit, and we believe that any perceived negative impact caused by including letters of credit as "loans" pales in comparison to the benefit that will be derived from encouraging banks to issue these instruments in support of housing and other community development for low- to moderate- income individuals.

## VI. EXPANSION OF ASSESSMENT AREAS

We request that the Federal Reserve update the concept of assessment areas. Assessment areas are currently based upon the concept that branches are the predominant channel for delivering bank products and services. While branches will continue to play an important role, they are becoming a less and less predominant channel through which customers conduct banking business in today's world. With the proliferation of technology such as internet banking and other Fintech, banking services are now often delivered with customers rarely visiting branches, and it is anticipated that in the future branch visits will become even less frequent.

We believe that the Federal Reserve should expand its view of the "local community" to accommodate the concept that an assessment area should include all areas where deposits are taken by banks, and/or where services are provided (whether in person or electronically through technology offered by the bank). As an alternative to the forgoing approach, the Federal Reserve should give credit for all CRA loans and investments nationwide but provide a multiplier for CRA loans and investments in existing assessment areas under the current CRA assessment area construct. This will encourage lending and investment in local communities while still promoting competitive efficiencies in community development. We believe that such changes will ultimately facilitate more competitive and efficient community development finance, by creating more sources of funding from a wide variety of sources for community development.

## VII. CONCLUSION

We believe that the Federal Reserve desire to update the CRA presents a real opportunity for the Federal Reserve to modernize the Act in support affordable housing in the United States, which is quickly becoming a crisis within this nation. The changes proposed in the ANPR should

facilitate innovative, creative and complex financing structures such as the GNMA Qualified Investments and other Federally Guaranteed Qualified Investments, instead of limiting the ability of banks to provide funding to affordable housing through this safe and sound structure. Changes to the CRA should clearly treat Federally Guaranteed Qualified Investments very differently than Other Community Investments. Other areas of banking law clearly distinguish between the various types of investment based upon the risk profile of each, and the CRA to be updated to be consistent with these other areas of banking law. In addition, we believe that the CRA should clearly designate letters of credit as loans for purposes of its lending tests and loan to deposit ratios. The foregoing items are low-hanging-fruit that will add tremendously to the flexibility of banks to support affordable housing in a safe and sound manner.